No. 11000

In the United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

RUBY M. BROWN,
Appellant,
vs.
NEW YORK LIFE INSURANCE COMPANY,
Defendant,
FEDERAL DEPOSIT INSURANCE CORPORATION,
Appellee

BRIEF OF APPELLEE

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF OREGON

MAGUIRE, SHIELDS & MORRISON,
ROBERT H. AGNEW,
Attorneys for Appellee,
723 Pittock Block,
Portland 4, Oregon.
JAMES M. KANE,
135 So. LaSalle Street,
Chicago 3, Illinois.

EDWARD C. KLEIN,
135 So. LaSalle Street,
Chicago 3, Illinois,
Of Counsel.

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BRIEF OF APPELLEE

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF OREGON

Statement of the Case

To the chronology of events stated in appellant's statement of facts there should be added the following:

Edward N. Brown, during the time he was employed as teller, assistant cashier, director and vice president of the Harney County National Bank (hereinafter referred to as the Bank), engaged in systematic pillage of its funds and assets. The Bank's deposits were something over $1,200,000; he succeeded in misappropriating about $416,000

(R. 16, 17). He accomplished this by a variety of means such as withholding deposits, making unauthorized withdrawals from customers' balances, taking the Bank's cash, retaining payments made by its borrowers on notes and keeping the notes in the note pouch as bank assets, and looting the Bank's accounts with correspondent banks.

By juggling customers' accounts and deposits alone, such as withholding deposits and making unauthorized withdrawals, from a date prior to 1935 up to the time of his suicide on August 6, 1942, he embezzled and misappropriated over $223,000. These peculations are scheduled by years and set forth in the stipulated evidence (R. 17).

He succeeded in concealing his crimes not only from other officers and stockholders of the Bank, but from the national bank examiners until the day of his death.

In 1935 he took out with the New York Life Insurance Company the policies of insurance involved (R. 3), and all of the premiums, with the exception of one, which could not be traced, were paid by the Bank in honoring ten checks for the sum of $297.20 each and one check for $310.40 (R. 57, 58), which Brown drew with seeming indiscrimination upon either the account carried in the Bank designated "Edward N. Brown, Personal", or "Edward N. Brown, Special" (R. 6-14, paragraphs X to XIX). At the time each of these checks for insurance premiums was presented to the Bank and honored by it, the books of the Bank reflected credit balances in the respective accounts on which the checks were drawn in excess of the amount of the checks. These apparent credit balances were in fact fictitious because (a) at all times from January 1, 1935, to the date of his death he was indebted to the Bank by reason of his thefts, embezzlements and misappropriations in sums vastly exceeding the apparent credit balances in his favor shown on the Bank's books; (b) on four occasions the purported balances in Brown's personal account were built up with credits representing salary and stock dividend payments wrongfully taken by Brown from the Bank, see R. 6, par. X; R. 8, par. XII; R. 11, par. XV; R. 13, par. XVIII; on one other occasion with a salary payment plus a transfer from one of his several other accounts, viz., his grain account, see R. 9, par. XIII; on still another occasion with a salary payment, currency of $240 from an unexplained source and the proceeds of a $100 Hearst Publication bond, see R. 12, 13, par. XVII; and on the last such occasion the balance in his personal account was made up of the proceeds of the sale of livestock, see R. 14, par. XIX, there being no direct evidence that Brown acquired the livestock with other than embezzled or misapplied bank funds; (c) the purported credit balances in Brown's special account were built up with currency from unexplained sources, R. 7, R. 9, par. XIV; R. 11, par. XVI, transfers from purported balances in his personal account, R. 7, R. 10, par. XV; R. 11, par. XVI, created with salary and dividend payments wrongfully taken by Brown from the bank, R. 11, par. XV; R. 12, par. XVI, rental from property and proceeds of sale of livestock, bonds or other property—see R. 9, par. XIV; R. 10, par. XV; R. 11, par. XVI, there being no evidence that Brown acquired the livestock, bonds or other property with other than embezzled or misapplied bank funds.

When the Bank honored and paid the checks no one connected with the institution had any knowledge of Brown's defalcations or the fact that he owed the Bank, rather than that the Bank owed him, R. 15. He made his mother beneficiary of the insurance, but at no time did she give any consideration therefor and he was not indebted to her in any amount.

After Brown's death it was discovered that the Bank's capital was impaired and it was unable to meet the demands of its depositors.

The Bank made application for financial assistance to the Federal Deposit Insurance Corporation (hereinafter referred to as FDIC), which had insured the Bank's deposits as provided by law. FDIC approved the Bank's application and agreed to purchase the Bank's unacceptable assets pursuant to powers conferred upon it by Federal statute (U. S. C. Title 12, Sec. 264 (n) (4) quoted in appendix p. —). Thereupon the FDIC and the Bank, on August 29, 1942, executed a contract for the sale to and purchase by FDIC of certain of the Bank's assets. The assets so acquired by the FDIC were those not considered of sound banking quality, having an aggregate book value of only $598,646.34 exclusive of the $800,000 note given by the Bank to FDIC and the Brown shortage set up in Exhibit A (R. 111) in two items, viz., Special Account for Adjustment, $150,000, and *Claim* v. *Edward Brown Estate,* $268,187.03. This sale was part of a transaction, whereby a second bank, The United States National Bank of Portland, Oregon (hereinafter referred to as the Purchasing Bank), was to take over the deposit liabilities (R. 88 and 89) and acceptable assets of the Bank. In further consideration of assuming the Bank's deposit liabilities the Purchasing Bank was to receive the consideration paid by the FDIC to the Bank for the unacceptable assets. The depositors of the Bank were then to become depositors of the Purchasing Bank.

The purchase price paid by the FDIC to the Bank was equal to the difference between the agreed value of the assets classified as acceptable by the Purchasing Bank and the amount of the deposit liabilities assumed by the Purchasing Bank (R. 91, 92, 93, 99, 100). The initial cash price paid by FDIC was $906,856.47 (R. 99 and 100), (which was far in excess of even the $598,646.34 book value of the assets purchased), and FDIC agreed to pay such additional sums as might be necessary to meet the Bank's liability to any depositor or depositors not included in the list of deposit liabilities attached to the contract. The Bank, pursuant to the contract, delivered the acceptable or bankable assets including the amount of the initial purchase price, to the Purchasing Bank, thereby enabling the latter to assume and pay the entire deposit liabilities (R. 89).

Proceedings Below

The New York Life Insurance Company had issued two policies of insurance on the life of Brown in the sum of $10,000.00 each, in which policies Ruby M. Brown was named as beneficiary.

Upon Brown's death, Ruby M. Brown, as beneficiary, made claim for the full amount of the insurance policies. Two checks were issued to her by the insurance company for a total sum of $20,582.00. The insurance company, upon discovery that the FDIC had a claim against the proceeds of the policies, stopped payment on these checks. Whereupon Ruby M. Brown instituted this action against the insurance company.

The insurance company answered by depositing the funds in court and asking for an order requiring the claimants to interplead. By stipulation an order was entered discharging the New York Life Insurance Company of liability and setting up adversely the claims of Ruby M. Brown and FDIC.

A pretrial conference was held between the FDIC and Ruby M. Brown, resulting in the entry of a pretrial order defining the questions of fact and law to be determined by the court (R. 2-32).

The trial court decided that by reason of the wrongful and unlawful use by Edward N. Brown of the assets and property of the Bank a constructive trust arose in favor of the Bank, and in favor of the FDIC, as assignee of said Bank, for that proportion of the proceeds of said insurance policies as the amount of the premiums paid from the Bank's funds bears to the total amount of the premiums paid on said policies (R. 32).

Plaintiff filed a motion to amend the pretrial order and for new trial, which was denied (R. 77), whereupon Plaintiff appealed from the judgment and from the order denying her motion (R. 78). The opinion of the court below is reported in 58 F. Supp. at page 252.

Argument As To Specification of Error I

Appellant's specification of Error I contends that the trial court erred in concluding that FDIC succeeded to or became subrogated to the rights, if any, of the Harney County National Bank against the proceeds of the policy for the following alleged reasons:

(A) When FDIC made good the shortages in the depositors' accounts, the right of the Bank or its depositors to pursue the claim against Brown's insurance was destroyed, otherwise a dual recovery would be permitted.

(B) After payment by FDIC there was in existence no enforceable claim against insurance proceeds which the Bank could assign to FDIC and which would support a recovery in favor of FDIC.

(C) FDIC has no right of subrogation.

(D) The assignment to it of the assets of the Bank or the depositors' claims cannot assist it.

Appellant's argument in support of contentions (A) and (B) attempts to analogize the position of the FDIC, in the case at bar, to that of a surety company on a fidelity bond, citing in support thereof as the controlling case, *American Surety Co.* v. *Bank of California* (1943), 44 F. Supp. 81, aff'd (CCA 9) 133 F. (2d) 160.

A comparison of the facts in the *American Surety Co.* case with those in this case discloses that no such analogy may, with propriety, be drawn. Accordingly, appellant's contentions are not well founded and the *American Surety Co.* case, as will hereinafter be shown, cannot be considered as controlling or applicable to the facts in this case.

Appellant's argument in support of contentions (C) and (D) attempts to project the doctrine of equitable subrogation into this case. We submit, however, that the FDIC acquired its cause of action herein by assignment from the Bank rather than by way of subrogation to the rights of depositors.

Let us first consider the method by which the FDIC acquired its cause of action herein:

The FDIC, an agency of the Federal Government, is a corporation organized and existing under and by virtue of an Act of the Congress of the United States, *F. D. I. C.* v. *Mangiaracina* (1938), 198 A. 777, 16 N. J. Misc. 203; *U. S.* v. *Doherty* (D. C. Neb. 1937), 18 F. Supp. 793.

The FDIC insured the deposits of the Bank.

Because of Brown's peculations, the Bank's capital became impaired and it was unable to meet its deposit liability, thus prompting the Bank's application to the FDIC for financial aid to protect the depositors of the Bank.

There are two methods by which the FDIC may protect the depositors of insured banks in financial difficulties:

> 1. By paying the claims of depositors in an insured bank which closes without making adequate provision for payment of its depositors. Under the statute this method is employed only where the bank is placed in

receivership. It involves the usual procedure of taking offsets, proving claims and obtaining assignments of claims, and is commonly referred to as the *pay-off* procedure. The liability of the Corporation under this procedure is fixed by the terms of the statute, and does not exceed $5,000 per depositor (U. S. C., Title 12, Sec. 264 (l) (1).)

2. By advancing cash to an insured bank, through the medium of a loan or by a purchase of assets of the bank, to replace substandard assets in order to facilitate the contemporaneous assumption of its deposit liabilities by another insured bank. This is commonly referred to as the *purchase* procedure. The liability of the Corporation under this procedure is not fixed by the terms of the statute but by negotiation and contract. The statute *authorizes but does not require aid* under this procedure. It expressly provides that the advances shall be ''upon such terms and conditions as it (i. e. the FDIC) may determine'' (U. S. C., Title 12, Sec. 264 (n) (4)). The Corporation may (1) limit precisely the amount of any advance which it makes and (2) make the advance by loan secured in whole or in part by the assets of the bank aided, or by the mechanism of purchasing assets, as was done in this case.

For a discussion of the power of the FDIC to make such a contract and its rights thereunder see *Thomas P. Nichols Co.* v. *National City Bank* (1943), 48 N. E. (2d) 49, cert. den. 320 U. S. 742; *Lamberton* v. *FDIC,* 141 F. (2d) 95.

In this case the FDIC met the contingency by the purchase method in the following manner: The Purchasing Bank purchased the acceptable assets of the Bank in consideration of its assumption of the Bank's deposit liabilities. The FDIC, pursuant to an appropriate resolution of its Board of Directors (R. 79), purchased the remaining assets of the Bank at a price fixed by the difference between the value of the assets purchased by the Purchasing Bank and the aggregate amount of the deposit liability of the

Bank. The cash thus realized by the Bank from the sale of its remaining assets to the FDIC was then turned over to the Purchasing Bank as further consideration for the aforesaid assumption of deposit liabilities. In accordance with its resolution the FDIC entered into an agreement with the Bank, the pertinent parts of which are quoted in the appendix *infra* at p. — and the entire agreement appearing in the record at p. 88 *et seq.*

This method is frequently utilized by the FDIC. Of the 390 insured banks which closed because of financial difficulties between 1934 and December 31, 1942, 150 banks with 902,000 accounts and $383 million of deposits were aided by the Corporation through advances to the extent of $170 million under this procedure. By comparison, during this period 240 banks with 364,000 depositors and $102 million of deposits were placed in receivership and the Corporation paid $81 million of claims of insured depositors.[1]

Among the assets purchased by and assigned to the FDIC was the Bank's claim against Edward Brown. This claim was founded on the loss sustained by the Bank by reason of the peculations of its funds and properties by Brown, its employee, director, and officer, amounting eventually to $416,777.73 (R. 59). It is apparent therefore that the FDIC acquired its cause of action herein by express contract with the Bank and not by way of subrogation.

Appellant's misconception of the relationship between the FDIC, the Bank, its depositors and the appellant is best illustrated by the following excerpt taken from page 9 of her brief:

> "In our case here, it is claimed that Brown wrongfully abstracted money from depositors' accounts in the Harney County National Bank under such circum-

[1] 1942 FDIC Annual Report, p. 11. (The courts will take judicial notice of the annual reports to Congress of government agencies.) *Texas and Pacific R. R. Co.* v. *Pottoroff* (1934), 291 U. S. 245, 254.

> stances that the Bank was liable for the losses. FDIC had insured the depositors' accounts and it responded and has made good the shortages in the depositors' accounts, taking an assignment of the depositors' claims against the Bank. In this action FDIC is attempting to assert the remedy which the depositors and the Bank had to reach the proceeds of the policies on the life of the wrongdoer, and under the doctrine of the *American Surety Co.* case it must be held that when FDIC made good the shortages in the depositors' account that it merely did what it undertook to do for a consideration and therefore its payment discharged the debt and it cannot aid its position or change the consequences by taking an assignment or anything else."

The foregoing is utterly fallacious in that the money abstracted by Brown was the property of the Bank not "money from depositors' accounts." The relationship between a bank and a depositor is that of debtor and creditor.[2] When Brown embezzled funds from the Bank, the Bank suffered a loss of assets but continued to be indebted to its depositors. Consequently, the Bank alone (not the depositors) acquired a right of action against Brown. In the first sentence of the above quotation appellant seems to have been laboring under the notion that the situation is as though the bank had closed because of inability to meet its deposit liabilities and that a receiver had been appointed, in which event the receiver would have succeeded to the Bank's right of action against Brown and the depositors (or FDIC, as statutory insurer-subrogee) would have been relegated to filing claims with the receiver as

[2] *Dahl & Penne, Inc.* v. *State Bank of Portland* (1924), 110 Ore. 68, 71, 222 Pac. 1090;

Mahon v. *Harney County Nat'l Bank* (1922), 104 Ore. 323, 329, 206 Pac. 224;

Steele v. *Bank of California* (1932), 140 Ore. 107, 112, 9 P. (2d) 1053;

In re Edwards Estate (1932), 140 Ore. 431, 440, 14 P. (2d) 274; 7 Am. Jur., Banks, p. 444, Sec. 444.

general creditors. However, that did not occur, but instead the FDIC properly acquired the right of action herein by way of purchase and assignment fro mthe Bank rather than from the depositors. So much for the first sentence of the foregoing quotation.

The second sentence thereof is a pure figment of appellant's imagination. FDIC insured the depositors' accounts but only to the extent of $5000.00 for each depositor. Through the method employed by the FDIC herein shortages in the Bank's assets were restored with cash supplied by FDIC, which made possible the assumption of the entire deposit liability by the Purchasing Bank. The Bank's liability to the depositors was assumed by the Purchasing Bank and the Bank's liability was extinguished by operation of law under the doctrine of novation when the depositors dealt with the Purchasing Bank in such manner as to release the Bank. *City National Bank* v. *Fuller* (CCA 8), 52 F. (2d) 870. The FDIC did not in fact, constructively or otherwise, take any assignment of the depositors' claims against the Bank and could not have done so because such claims were retained by the depositors and became obligations of the Purchasing Bank under its contract of assumption with the Bank.

As to the third sentence of the quotation, appellant errs in that she states that the "FDIC is attempting to assert the remedy which the depositors * * * had to reach the proceeds of the policies * * *." As hereinbefore stated, the depositors had no right of action against Brown whatsoever. The FDIC claims through the Bank, not through the depositors. The FDIC did not, by purchasing the assets of the Bank, discharge a debt. It was under no obligation to the Bank and the purchase of the assets was a transaction for value.

The appellant contends that the instant case is governed by the doctrine laid down in the case of *American Surety Co.* v. *Bank of California,* supra.

In the *American Surety Co.* case an insurer paid the actual amount of the loss, $6,562.33, to its insured, the employer of the defaulting employee under a fidelity bond. The loss was alleged to have been incurred by the insured's employee procuring the genuine signature of his employer to checks on which he had inserted the names of fictitious payees. By forgery of the fictitious payees' endorsements the employee obtained the proceeds of the checks. In denying recovery to the insurer against the paying bank under the theory of subrogation this court in its opinion said:

> "The right of subrogation is a creature of equity, applicable where one person is required to pay a debt for which another is primarily responsible, and which the latter should in equity discharge. * * * Accordingly, subrogation will not operate against an innocent person wronged by a principal's fraud. A surety may pursue the independent right of action of the original creditor against a third person, but it must appear that said third person participated in the wrongful act involved or that he was negligent, for the right to recover from a third person is merely conditional in contrast to the right to recover from the principal which is absolute. The equities of the one asking for subrogation must be superior to those of his adversary. If the equities are equal or if the defendant has the greater equity, subrogation will not be applied to shift the loss.
>
> * * * * * * *

It also stated that:

> "The cases, dealing with the surety's alleged right of subrogation to the claim of the original creditor against a third party with whom the indemnitor is not in privity, indicate that the result reached depends upon a careful analysis of the facts involved."

Throughout its opinion in the *American Surety Co.* case the Court was dealing with an asserted right in personam which, if upheld, would have required the bank to again pay the sums abstracted by the defaulter to the banks loss whereas here we are dealing with a right *in rem* (the insurance proceeds) and no attempt is being made to subject Mrs. Brown to personal liability. Moreover the insurance was a gratuity, she was not wronged by Brown's fraud, she will suffer no loss and as will be pointed out *infra* all equities favor appellee's claim, none favor hers.

The diagram appearing in appellant's brief attempting to illustrate the similarity between the case at bar and the *American Surety Co.* case is fatally defective in several important aspects. At the outset it should be noted that the contract with the Bank and its assignment of assets to the FDIC are totally disregarded. The diagram is entirely erroneous without giving consideration to the assignment, because:

1. The depositors had no right of action against Brown.

2. Prior to the assignment the FDIC had no right of action against Brown, for it could obtain no derivative right by subrogation from the depositors, because:

(a) It paid nothing to the depositors.

(b) The depositors had no right which could be subrogated.

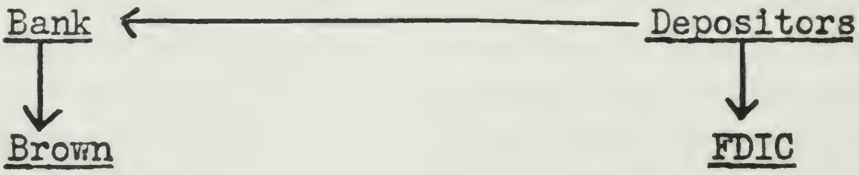
Furthermore, it did not stand in the position of a surety as to Brown for it insured the Bank's deposits, not Brown's fidelity.

3. The depositors assigned nothing to the Bank or to the FDIC.

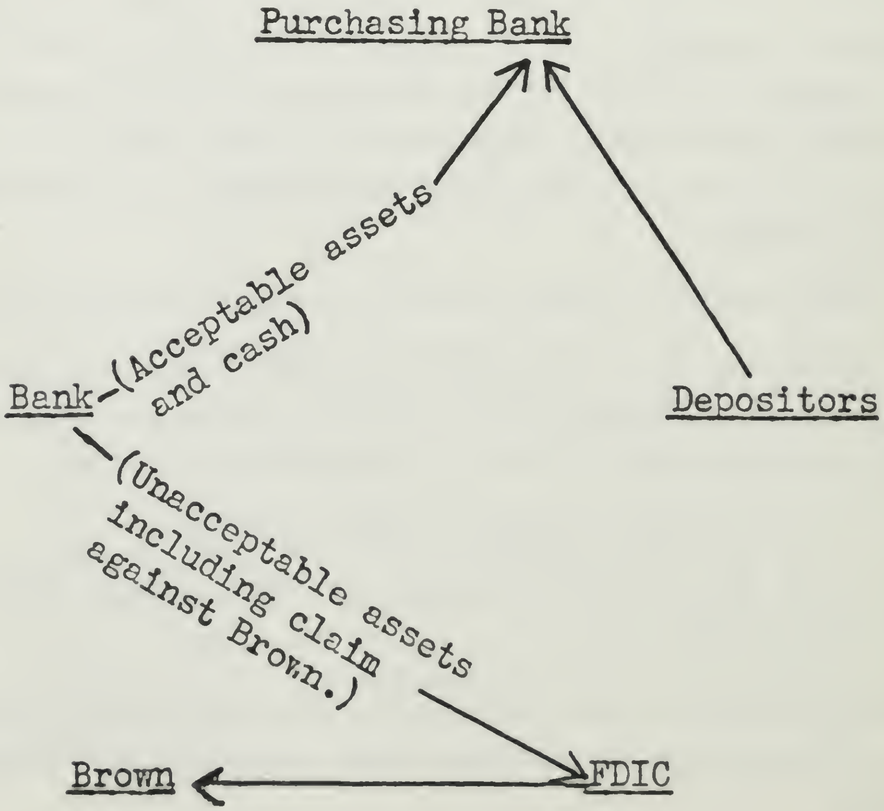
4. The FDIC was an assignee for value of the Bank's claim against Brown and not a subrogee of the depositors.

5. The FDIC took no assignment of the depositors' claims against the Bank.

Prior to the execution of the contract and the assignment the relationship of the parties was as follows:


Bank
Depositors
Brown
FDIC

After the execution of the contract and the assignment ment the relationship was as follows:


Purchasing Bank
(Acceptable assets and cash)
Bank
Depositors
(Unacceptable assets including claim against Brown.)
Brown
FDIC

FDIC did not insure the Bank or the depositors against Brown's dishonesty. It insured each depositor to the extent of $5,000.

Had the Bank closed and FDIC paid its deposit insurance liability to the depositors, as required by statute in such cases, it would have become subrogated to their rights against the Bank to the extent of the payment made (U. S. C., Title 12, Sec. (l)(7)). FDIC *did not* do this. Rather than permit the Bank to close, FDIC, pursuant to the Bank's application for financial assistance, purchased certain assets of the Bank and paid cash therefor, which it had authority to do, to the end that the Bank could make provision for payment to the depositors (U. S. C., Title 12, Sec. 264(n)(4)). The assets so purchased included the Bank's claim against Brown (R. 93). The depositors were strangers to this purchase transaction. The case at bar and the *American Surety Co.* case stand for different propositions and the appellant's faulty diagrams and incorrect assumptions of facts cannot reconcile them. *American Surety Co.* v. *Bank of California, supra,* is good law, but it is inapplicable to this case.

Weighing the equities between FDIC and appellant, it is submitted that the FDIC is a purchaser of assets for value including the Bank's claim against Brown arising from its unwitting investment in the insurance policies here involved. The proceeds of the insurance policies were not created by Brown's use of his own funds, nor by the funds of appellant. It was created by funds of the FDIC's assignor, the Bank.

The alleged equities of the appellant are that she is a beneficiary under a policy of insurance on the life of her son; that her son had repaid loans made by her to him; that her son was under no obligation to so designate her and she paid nothing for being so designated. Whereas the equities of appellee include the fact that the premiums for the insurance were paid with the Bank's funds dishonestly and criminally misappropriated and embezzled by her son from the Bank in which he was a trusted employee, officer and director, and the further fact that Brown was heavily indebted to the Bank for concealed thefts by reason of which both the Bank and FDIC have suffered huge losses.

Do the contentions of the appellant, Ruby M. Brown, appeal to the conscience of equity when the facts in the case at bar disclose that her son was false to his trust; that through concealment of his frauds he procured the Bank to honor his checks; that the Bank and FDIC have suffered huge losses as the result of his transgressions; that the insurance premiums were paid by Bank funds; that she gave no consideration to her son or the insurance company, but because her guilty son placed her name in the policy she demands the fruits of his fraud and crime? All the equities, therefore, are in favor of the FDIC, none exist in favor of Brown or his beneficiary. Counsel asserts that "Appellant does not claim through the wrongdoer but under solemn contracts * * *."[3] She made no contract, she furnished no consideration for the contract. The contract was entered into by the wrongdoer. The consideration received by the insurance company was paid not with the wrongdoer's funds but with the funds of the wronged Bank.

The FDIC as assignee of the Bank's cause of action against Brown is proceeding to follow funds which Brown had embezzled or misappropriated from the Bank and invested in a life insurance policy. It is not asserted that the Bank could not have done so, and what the Bank could do, FDIC can also do, as it has by express contract and assignment acquired the Bank's claim against Brown.

The policies of insurance in the case at bar are no more solemn contracts than those in the case of *Jansen* v. *Tyler* (Two Cases), (1935), 151 Ore. 268, 47 P. (2d) 969, 49 P. (2d) 372, in which the wife and daughter of the insured,

[3] P. 12, Appellant's Brief.

who was the defaulter, were the claimants, as beneficiaries, against the receiver of the company defrauded. The appellant's position in this case is no different than the position of the wife and daughter in that case. They were beneficiaries, and so is the appellant here. The insured had misapplied funds and used them to pay the premiums for the policies under which they claimed. That is precisely the appellant's position here. The proceeds of the policies were applied in repayment of the misappropriations in proportion to the amount of the premiums paid with misappropriated funds. That is what the trial court ordered in this case, and it should be sustained.[4]

Specifications of Error II

Contentions of the Parties

In appellant's specification of Error II, it is asserted that:

> "The sole question for determination is whether the premiums were paid with funds wrongfully embezzled or misappropriated from the Bank."

The gravamen of appellant's argument seems to be that "embezzled funds" were not directly traced into the premiums paid by the defaulter on the life insurance policies here involved. However, appellant has either failed to consider or overlooked the question of whether misappropriated funds were used to pay these premiums. In the interest of clarity, it is deemed advisable at this juncture

[4] *Holmes* v. *Gilman* (1893), 138 N. Y. 369, 34 N. E. 205, 20 L. R. A. 566;
Truelsch v. *N. W. Mutual Life Ins. Co.* (1925), 186 Wis. 239, 202 N. W| 352;
Mass. Bonding & Ins. Co., v. *Josselyn* (1923), 224 Mich. 159, 194 N. W. 548;
Vorlander v. *Keyes* (C. C. A. 8, 1924), 1 F. (2d) 67.

to epitomize appellee's position in this main aspect of the case, which is:

1. Appellee agrees that the basic question in this case is whether the various premium payments were paid with funds belonging to the defaulter or with funds wrongfully embezzled or misappropriated (actual or constructive, directly or indirectly) from the Bank.

2. While the court below did not predicate its decision upon a finding that the various premium payments (except one) were paid with funds directly embezzled by Brown from the Bank, yet the Court observed (R. 48) that such a "finding could be made in the case at bar" and appellee submits for reasons which will be outlined below that the various premium payments, save one, were paid with funds embezzled either actually, indirectly or constructively from the Bank by Brown.

3. That the various premium payments (except one) were paid with funds wrongfully misappropriated from the Bank by Brown for the several reasons so learnedly stated by the lower court.

4. Appellant, standing in the shoes of the defaulter, is estopped and precluded as a matter of federal public policy from resorting to the very acts of thievery, misapplication and concealment condemned by the federal statutes relating to national banks as a means of thwarting the purposes of those statutes or as a means of preventing the FDIC, as assignee of the Bank, from recovering property into which the Bank's funds were dishonestly, criminally and unlawfully converted. Each of these propositions will be discussed in the order stated, followed by discussion of other questions raised.

As to the Matter of Tracing Embezzled Funds

Appellant would have us believe that the lower court in stating:

> "The cardinal factor is that no item of the embezzled funds is traced *directly* into the premiums of the insurance policies, nor into the bank accounts, which Brown maintained with the Harney County National Bank," (Italics supplied)

meant to exclude any finding or conclusion that embezzled funds were indirectly or constructively traced into the premium payments. The court's use of the word "directly" is alone enough to negative appellant's version, but if further proof be required that the court did not so intend, we need but to read Findings of Fact XX and XXI to the effect that all premiums (but one) were paid with funds of and belonging to the Bank and no part of the same were paid from funds or credits belonging to Edward N. Brown, and to Conclusions of Law I and II to the same effect, to say nothing of the court's scholarly analysis of the facts and the applicable law. The court below concluded (and we think correctly) that embezzled funds were either indirectly or constructively traced into the premium payments.

It is well known, and we think this court will take judicial notice of the fact, that each defaulting bank officer or employee uses a somewhat different technique from most other defaulting bank servants, not only in effecting his peculations but also in concealing them. The devices employed by Brown were unusually cunning and so well concealed that it has been impossible to trace the origin or disposition of more than a segment of his defalcations. Seemingly, a large portion of Brown's shortages consisted of cash abstractions, presumably from the till, which he concealed by making improper charges to depositors' accounts, by not recording customers' deposits or payments on customers' notes, by withdrawing ledger sheets and otherwise. Each time he withdrew the cash, he not only violated the provision of U. S. C., Title 12, Sec. 375a, which prohibits an executive officer or director of a national bank from borrowing money or otherwise becoming indebted to the Bank, but he also violated the criminal section of the National Bank Act (U. S. C., Title 12, Sec. 592) by abstracting and embezzling the Bank's funds. Moreover, by not placing either in the till, or among the assets of the Bank, some evidence of his indebtedness in the form of a countercheck, debit ticket or note, he fraudulently and illegally concealed the abstractions. It should require no citation of authority, even if there were no statutory requirement that he take the oath as director prescribed by U. S. C., Title 12, Sec. 73, to support the proposition that, notwithstanding his peculations, he had the legal duty to place some evidence of his indebtedness among the assets of the Bank and otherwise to reveal to the officers, directors and bank examiners the nature and extent of his indebtedness.

Brown maintained several checking accounts in his name on the books of the Bank. Some of these were captioned "Grain" account, "Steer" account, "Edward N. Brown, Personal," and "Edward N. Brown, Special." The record made by Appellant is conspicuously silent in even attempting to explain the purpose of these several accounts. However, circumstances indicate that Brown maintained or used these accounts as an integral part of his scheme to conceal his peculations, such as unexplained and seemingly indiscrimate transfers from one account to another, presumably to meet outstanding checks; proceeds of the sale of livestock were credited in some instances to his special account and other times to his personal account; checks issued in payment of life insurance premiums were drawn against both his personal and his special account; unexplained credits purporting to be represented by currency or cash in both accounts. These circumstances, considered in the light of Brown's unscrupulous pillage and faithlessness toward the bank, negative any presumption of honesty on his part and shifts to appellant the burden of proving honesty in all of his transactions in these accounts. *McConnel* v. *Henochsberg,* 11 Tenn. App. 176. Brown's death does not overcome the prima facie showing of complete dishonesty, *Meyers* v. *Baylor University* (Tex.), 6 S. W. (2) 393, 394.

Appellant has not met this burden. It must, therefore, be presumed that Brown maintained these several accounts for the purpose of concealing transactions which might have been discovered had he maintained but one checking account in his name. We respectfully submit that the Court should look through the form and to the substance of the transactions and conclude that in effect Brown maintained but one deposit account in which there was at all times actually a very substantial overdraft and that credits resulting from legitimate income of the defaulter (if there was any) should be applied to the pre-existing overdrafts rather than to pay those checks which would serve the best interests of the embezzler and those whom he sought to favor to the prejudice and at the expense of the Bank to which he owed undivided fidelity and loyalty. Does it matter that he did not run bookkeeping entries through his accounts to reflect all of his peculations when he had the duty so to do, and does his omission in this regard entitle appellant to rely on Brown's culpable acts? Certainly not.

The fallacy of appellant's contention is in the refusal to recognize that a depositor owns no part of the bank's funds, and that the relationship between them is solely that of debtor and creditor. A bank is not bound, and in fact has no right, to pay out *its* funds in honoring a check drawn upon it, unless at the time of presentation this debtor-creditor relationship results in a credit balance in favor of the drawer equal to the amount of the check.

True, under certain circumstances a bank may permit an "overdraft"—itself a significant term, but permission implies knowledge. Brown, assistant cashier, director and vice president, concealed his wrongs and kept from the Bank all knowledge that the apparent balance was not actual. As a result of such concealment and violation of his duty to disclose his peculations, the Bank when it paid and honored Brown's checks for premiums was not paying a debt it owed to him, but was unknowingly investing its funds in a life insurance policy payable to appellant.

The law has never concerned itself with defining or describing all possible ways in which fraud, deceit, and breaches of trust can be accomplished. It has contented itself in declaring that however done, however new and ingenious the means and methods, its arm will reach out to correct the wrong and deprive the wrongdoer, and those who, without valuable consideration, claim through him, of the fruits of the wrong.

It was stipulated that during Brown's employment his peculations from the Bank amounted to $416,777.73, and that from 1935 to 1942 he embezzled and misappropriated from one source alone, viz., false entries, withheld deposits made by depositors, and by unauthorized and wrongful withdrawals from credits and accounts of depositors the sum of $223,586.35 (R. 17).

While the appellant did not concede the truth of these facts, it did admit that the FDIC could produce evidence in support thereof, yet appellant waived their production (R. 18). These facts, therefore, remain undisputed.

All of the checks in payment of premiums on the policies were drawn between 1935 and 1940 by Brown on his personal or special accounts with the Bank except the last premium on policy No. 12748022 (R. 6). The various items of credit appearing to his accounts at the times the checks in payment of premiums were honored were agreed to (R. 6-14). The FDIC did not admit that they were proper items of credit or that on the dates that they were recorded Brown had any actual credit balance in the Bank (R.14). So far as the items are concerned there is neither conflict nor dispute.

The trial court was not misled by the argument of the appellant that the embezzled funds with which the premiums were paid must be definitely and specifically traced, and relying on the case of *McConnel* v. *Henochsberg,* 11 Tenn. App. 176, observed:

> ''Criticism is made of the application of that case to the situation here because of the fact that the court says 'it is evident that several thousand dollars of this stolen money was used by Henochsberg and did actually pass through his bank accounts.' The same finding could be made in the case at bar. However, this court does not place the decision here upon that basis, but upon the broad ground upon which the Tennessee court may also have relied, that the fiduciary who obtains property by breach of his obligations of confidence cannot equitably retain it.''

The facts of that case are almost identical with those of the case at bar. Henochsberg was an assistant cashier and over a period of years embezzled $329,591.75 of the bank's funds. The bank examination revealed that he had manipulated depositors' accounts in covering his operations in much the same way as did Brown. He, too, had purchased life insurance, but his wife and children were the beneficiaries rather than his mother. The premiums on the policies subsequent to January 1, 1920, were paid by checks drawn on the various accounts he had with the bank which he fed with the embezzled cash. The cash that passed through these accounts was far in excess of his salary and his own resources. The same question arose as to actually tracing the money used in paying the life insurance premiums and the other property involved, but the court decided the issue against the claimants and said:

> "While recognizing the settled rule that the misappropriated funds must be traced into the specific property before there can be a constructive trust impressed, we are of the opinion that where the trustee ex maleficio has pursued a systematic scheme and plan of stealing funds from the bank, where he sustains the fiduciary relation of assistant cashier and has direct supervision of the accounting department of the bank and abuses the confidence of the employers of the bank, and by the method employed uses the stolen funds taken by him from the deposits of customers, and at such times as it becomes necessary and expedient feeds a sufficient amount of the stolen funds into his own bank account to protect checks drawn by him on his accounts in the payment of life insurance premiums and payments on the other property sought to be impressed with the trust, that it constitutes such a tracing of the stolen funds into this property as to meet the exactions of the law with reference to impressing such property with a constructive trust. It would be a subversion of justice and all rules of equity to say, that a trusted employee charged with the duty of handling the funds of his employer, through a fraudulent scheme and systematic course of fraud and deception to steal the funds of his employer, and to mix such stolen funds with his own funds and out of the mingled funds, mingled with deliberate fraudulent intent to conceal and to hide away the identical funds stolen, and to invest such funds in property taken in his own name, could reap the fruits of his own misdoing at the expense of the employer."

* * * * * * *

The appellant denies that any embezzled funds were traced into Brown's accounts and by way of emphasis states in her brief.[5] ''In every instance the credits to his accounts are either salary or amounts received by him from outside sources.'' ''Outside sources'' might mean anything and possibly that is what appellant had in mind, because there are these unexplained items of cash and currency appearing in Brown's accounts when the premium checks were honored:

December 2, 1935	$150.00	''currency''	(R. 6).
October 3, 1936	50.00	''currency''	(R. 7).
October 23, 1939	250.00	''cash''	(R. 9).
October 21, 1937	240.00	''currency''	(R. 13).

The question of who had the burden of proof, and how that burden (if appellee's) was met and how appellant failed to sustain her burden is dealt with more fully under the subheading ''As to the Matter of Burden of Proof,'' infra, but it should be observed at this juncture that the breakdown of Brown's accounts is not for all of the months between 1935 and 1940, but only the months when the premium checks were honored. Although this is not intended as an analysis of Brown's various enterprises, there are several items that deserve more than passing notice. In the years 1938, 1939, and 1940 he sold livestock to the total of $15,353.30. The livestock was not a gift, it was not all that he had, but merely what he sold, yet his salary in 1937 was only $225 per month and in and after 1938 it was but $250 per month. Appellant offered not one scintilla of proof that the livestock was purchased with Brown's own funds. The premiums on the insurance here involved were nearly $600 annually. In 1935 he began buying real estate at a time when his salary was only $160.00 per month.

[5] P. 36 Appellant's Brief.

From 1935 to 1940 he bought real estate for which he had paid $6,433.03 and this was only the real estate he held at his death. Where did he get the money to pay for this real estate? His only actual resources about which there can be no question were two gifts of cash, one in 1930 of $2,300 and the other of $1,300 in 1931, but these sums were apparently dissipated since they do not appear in any amount in his accounts in the years 1935 to 1940. He borrowed $4,000 from his parents in 1938, 1939 and 1940, which he repaid. It is an irrefutable conclusion that his operations were founded by and nurtured with his peculations from the Bank. His only resources, besides the salary he drew, were borrowed funds of $4,000, but these are entirely inadequate for such operations. The funds passing through his grain and steer accounts were apparently the fruits of his operations with the Bank's funds and he drew on these accounts to feed his personal and special accounts from which the premium payments were made. Between 1935 and 1940 his peculations from one source alone were:

In the year 1935	$12,893.21
In the year 1936	3,031.52
In the year 1937	17,996.84
In the year 1938	40,982.14
In the year 1939	93,203.44
In the year 1940	39,780.33

Appellant concedes that the Oregon Supreme Court in *Jansen* v. *Tyler, supra,* has announced a rule which, if applicable to this case, would award to FDIC that proportion of the proceeds of the policies which the premiums paid from funds or property embezzled, misappropriated or wrongfully converted by Brown from the Bank, bear to the total premiums paid.

Tyler was the president and general manager of an investment company. He created an insurance trust for the benefit of his wife and daughter, some of the insurance premiums having been paid with funds misappropriated from the investment company. He was indicted for embezzlement and shortly thereafter committed suicide. The action was instituted by the receiver of the investment company against the trustees of the insurance fund to recover the proceeds of certain policies, the premiums of which were thus paid. The court held that Tyler was a trustee of the investment company and allowed a recovery. It said:

> "Where a fiduciary embezzles funds of his cestui que trust and uses same in building an estate in life insurance, equity will impress a trust in favor of the cestui que trust in the proceeds of such insurance for moneys so embezzled."

and on the rehearing:

> "It is well settled that whenever a trustee or other person in a fiduciary position wrongfully purchases land or personal property with trust funds, or funds in his hands impressed with a fiduciary character, and takes title to such property in his own name, without any declaration of a trust, a trust with respect to such property at once results in favor of the original *cestui que* trust or other beneficiary. The doctrine in regard to such a trust is of wide operation and is used by courts of equity in maintaining and protecting beneficial rights of property. It is applied to trustees proper, to executors, administrators, directors, and managers of corporations, guardians of infant wards, agents using money of their principals, partners using partnership funds, and to all persons who stand in fiduciary relations towards others. 1 Pomeroy, Equity Jurisprudence (4th Ed.) sec. 422." (Italics added.)

For the reasons stated by the court below and discussed *infra,* the rule laid down in the *Jansen* case is controlling here.

Tracing of specific funds is not necessary to impress a trust on the proceeds of insurance. The Wisconsin Supreme Court in the case of *Truelsch v. Northwestern Mutual Life Insurance Co.* (1925), 186 Wis. 239, 202 N. W. 352, 38 A. L. R. 914, decided a case similar in many respects to the case at bar. Paul Truelsch was a clerk and bookkeeper who falsified entries and trial balances to cover his withdrawal of cash from his employer's deposits before they were taken to the bank. It is not entirely clear from what source the premiums were paid on the life insurance he had purchased. When his misdeeds were about to be uncovered he committed suicide. The court said:

> "On the subject of tracing the funds, counsel for the respondent relies on the legal proposition that the burden was on the appellant to prove that the money embezzled went into the policies; that, when the funds cannot be traced, the equitable right of the cestui que trust to follow and reclaim a trust fund fails; that the right to follow and reclaim a trust fund is always based upon the right of property, and not on the theory of preference by reason of an unlawful conversion.
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> * * * * * * *
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> "Although in this case the proof of criminal conduct on the part of Paul was involved, it is very clear, on well-settled rules, that it was not necessary to prove either the embezzlement or the tracing of the funds beyond a reasonable doubt. Nor was it necessary in proving that the moneys embezzled were used to pay for the premiums, to show that the identical specie or bills abstracted were so employed. Whatever may have been the former rule, it is not now the law that one cannot follow money in equity because it has no earmarks."

We do not contend nor argue that if Brown had received a gift from his father in cash and had used some of that cash to pay a life insurance premium that the Bank or

FDIC would be entitled to the proceeds of the policy. Neither do we contend nor argue that if Brown had taken a part of the hypothetical gift from his father, brought it to the Bank as a special deposit (not a deposit for a special purpose) (see *Keyes* v. *Paducah and I. R. Co.,* C. C. A. 6, 61 F. (2d) 611, defining "special deposit" and "general deposit," and *Titlow* v. *Sundquist,* C. C. A. 9, 234 Fed. 613, defining "deposit for special purpose") to be delivered to the life insurance company in kind or to purchase therewith a draft from the Bank payable to the life insurance company, that the Bank's funds would have been used to pay the premium. However, nothing of that sort was done, and this being a case in equity, the court will not indulge in a fiction by saying, as appellant would have it do, that the situation is as though Brown made a special deposit or purchased a draft, when to do so would defeat, not promote, the ends of justice and the plain purpose of the Federal protective statutes enacted for the protection of the Bank, its depositors, and the FDIC. We do, however, earnestly assert and submit that if Brown took that gift and deposited it in the Bank, the Bank then acquired the ownership of the money and became obligated to account to him either in the form of a deposit account which could be set off against Brown's indebtedness or by way of direct application on Brown's indebtedness without entering it as a credit in his deposit account.

Assuming, but not conceding, that some of the credits appearing in Brown's deposit account represented funds derived by him from legitimate sources, Brown admittedly intended that title to those funds was to pass to the Bank. Having done so and having previously violated practically every trust and confidence imposed on him by the Bank and by the law, neither equity nor the law will then permit him to secretly and surreptitiously juggle or apply those credits to the payment of his insurance premiums, rather than to the reduction of his prior defalcations, thereby serving his best interests at the expense, and to the prejudice of his innocent, unwitting, trusting employer, the Bank, cf. *Grant Co. Bldg. Loan & Sav. Assn.* v. *Lemmon* (Ky., 1904), 78 S. W. 874, 875.

It is our position, therefore, that even if any of the credits which were reflected in Brown's account can be considered as funds received by Brown from legitimate sources (which appellee does not concede) that these credits operated either as a matter of law or in equity merely to reduce Brown's pre-existing indebtedness whether it be considered an overdraft or otherwise. Therefore there were no credit balances against which the insurance premium checks could be charged on the respective dates they were presented, but instead there were actual overdrafts which were increased by the payment of the premium checks. It follows that Brown used embezzled funds to pay the premium checks, and that embezzled funds were constructively, if not actually, traced into the premiums, save one. There was abundant evidence before the trial court to justify such findings.

As to the Matter of Tracing Misapplied Funds

The laws governing indebtedness to national banks by executive officers are explicit and stringent (U. S. C., Title 12, Sec. 375a), and as a director Brown was required under his oath honestly to administer the affairs of the Bank (U. S. C., Title 12, Sec. 73). He violated both provisions.

The deposit accounts Brown maintained at the Bank and on which he drew for the payment of the premiums created nothing more than a creditor and debtor relationship. They were no different than any other deposit account with a bank. The funds deposited are funds of the Bank and not the depositor. As such the funds were not earmarked and if he deposited more than he withdrew, then the Bank was his debtor, conversely when he withdrew more than he deposited, the Bank was the creditor. Obviously Brown had not borrowed the money and he was prohibited by law from becoming otherwise indebted to the Bank. It is equally obvious that the credit balances in his favor in these accounts were fictitious because he had deliberately failed to charge his withdrawals and indebtedness to the Bank. Therefore, despite the apparent credit in his accounts, whenever the Bank honored his checks for premium payments to the insurance company, it was paying its funds and not Brown's funds. The Bank, by honoring his checks, did not ratify or confirm his indebtedness because it had no knowledge of the facts and was unaware of the true condition of his accounts.[6] Therefore, his attempted use of the alleged deposits to pay the insurance premiums, rather than the application or credit of those deposits to his defalcations, was clearly misapplication of the funds of the bank and the court below correctly decided that misapplied funds of the bank were traced into the premium payments.

Appellant's position seems to be that Brown's embezzlements and abstractions are something apart, unrelated to, and disconnected from his deposit account. With that position, we disagree for the reasons soundly relied upon by the court below and the portion of our argument under the heading "As to the Matter of Tracing Embezzled Funds." However, let it be asumed, arguendo that appellant's version as just stated can be supported and that, broadly speaking, the situation is something akin to Brown having borrowed $416,000 on demand or past due notes and at the

[6] *Tilton* v. *Boland* (1934), 147 Ore. 28, 35, 31 P. (2d) 657; *Schomaker* v. *Petersen* (Cal., 1930), 285 P. 342; *Farnum* v. *O'Neill,* 252 N. Y. S. 900, 904; *Renland* v. *First Nat'l Bank* (Mont., 1931), 4 P. (2d) 488; *Miller* v. *Ahrens,* 163 Fed. 870, 877.

same time maintaining deposit accounts. What would his duty have been with respect to the use of the deposits?—knowing, 1st, that the Bank had a banker's lien on the commercial paper allegedly deposited by him for collection (see *Joyce* v. *Auten,* 179 U. S. 591; *Kane* v. *First National Bank* (C. C. A. 5), 56 F. (2d) 534, 85 A. L. R. 362, cer. den. 287 U. S. 603; 7 Am. Jur. Sec. 626, p. 453) and, 2nd, that the bank had the right to set off the balances appearing from time to time in deposit accounts (see 7 Am. Jur., Sec. 629, pp. 455-457), particularly where the depositor-borrower is insolvent and even though the debt were unmatured (see 7 Am. Jur., Sec. 632, p. 459).

As an officer and director who had taken a solemn statutory oath to faithfully serve the Bank, he was bound to credit those deposits on his indebtedness to the Bank rather than to use the deposits to build up an insurance estate for his mother. His breach of that duty was a patent misapplication of the Bank's funds. In legal effect, the deposit balances constituted collateral pledged by operation of law to secure the depositors' indebtedness and, to be sure, if he had converted securities or chattels which had been pledged as collateral, Brown would have been guilty of misapplication. *A fortiori* in the situation in the case at bar, his wrongful, dishonest use of the deposits for his selfish purposes constituted misapplication of the gravest type because he concealed his indebtedness from other officers and directors who could and no doubt would have applied the deposits to the reduction of Brown's shortages.

If, for any reason, there is a lack of tracing of embezzled funds into the premium payments, then to be certain such deficiency is clearly supplied by the tracing of the most flagrant and unconscionable species of misapplication.

The matter of set-offs of embezzlements against apparent credit balances in the defaulter's bank account was urged upon and the court considered it in the case of *McConnell* v. *Henochsberg, supra,* in which the facts are peculiarly similar to the case at bar. The FDIC in support of its position cites the same quotation from that case which it presented to the trial court:

> "But it is clearly apparent from the record that checks issued by him in payment of the life insurance premiums after January 1, 1920, and in payment of the other investments, and payments on the other property sought to be impressed with a trust herein, were paid out of moneys which did not belong to him, and that he had so mingled the stolen moneys with his own funds in the bank accounts as to make it impossible to actually ear-mark the stolen moneys as having been used exclusively in paying the life insurance premiums and the payments on the other property involved. It is contended for appellants that this would necessitate the application of the rule of set-off, and that the misappropriated funds should have been set-off against legitimate deposits. We think a sufficient answer to this contention is that, the bank officials had no knowledge, intimation or suspicion that Henochsberg was a defaulter with the bank until the morning of his suicide. Henochsberg had so manipulated these accounts, as well as his own, as to successfully conceal his shortages and thefts. In this situation there was no opportunity for the bank officials to resort to set-off."

The trial court correctly followed this case and found that:

> "All the money paid out upon checks issued by Brown against his paper accounts, belong to the Bank."

The appellant has cited *Duke* v. *Johnson* (1923), 127 Wash. 601, 221 Pac. 321, but it is without merit here. The depositor Lindeberg, although his checking account was good for the amount charged against his account, was indebted to the bank at the time the check in question was honored. The bank was aware of the indebtedness, but through choice had not exercised its right of set-off. There was no secret embezzlement or fraud involved and a constructive trust had not been applied to reach the funds in question.

The other case cited by appellant, *Peoples State Bank* v. *Caterpillar Tractor Co.* (Ind., 1938), 12 N. E. (2d) 123, has no effect here because once again the facts of that case show that there was no fraud; that the trust theory was not applied to decide the issues. It was a business transaction in which the bank set off its indebtedness against a depositor, and its rights were determined as of that time.

The point urged by the appellant for these cases might be helpful if it were not for the fact that the Bank at all times was at the mercy of Brown and could not exercise its rights against his accounts by reason of his fraudulent practices and concealment. Neither could the officers, nor directors, have authorized, permitted, or ratified Brown's acts without themselves violating Section 375a of U. S. C., Title 12.

The appellant cites *American National Bank* v. *King,* 158 Okla. 278, 13 P. (2d) 164, as authority for its position. The case represents a minority view which is not followed in Oregon. It holds that where a trustee *ex maleficio* uses funds to purchase insurance, the *cestui que* trust cannot recover the proceeds of the policy on the death of the trustee insured. It refuses to follow *Vorlander* v. *Keyes* (C. C. A. 8, 1924), 1 F. (2d) 67; and the majority view on the subject, and on the doctrine of commingling of funds says:

> "If we apply the 'bag' theory discussed in the briefs, there was contained therein the premiums and the sacrifice of a human life that the bank had no control over and no mortgage on."

While conceding that tangible property could be followed and recovered under the trust theory, it does not discuss and seems to have been wholly unaware of the principle of law that the relationship between a bank and depositor is merely that of a debtor and creditor and that the doctrine of set-off applies. The court stated that had King been charged at any time with the amount of the defalcation of which he was cognizant, there never would have been anything to his credit at the bank, but it concluded:

> "The theory of the plaintiff bank is that if it can establish that the bank's money paid the premiums, it gets the insurance, overlooking the fact that it took King's death to mature the contract of insurance and create the funds."

Small wonder that the trial court in considering, but refusing to follow, the case says:

> "The court apparently entertained an emotional dislike for the doctrine of recovery of the proceeds of an aleatory contract and upon this feeling the case is founded."

The law of the Oklahoma case is not recognized in Oregon, where the majority view prevails and was followed in the case of *Jansen* v. *Tyler,* discussed and analyzed *supra,* in which it was held that the *cestui que* trust recovery is not limited to the amount of the misapplied funds, but is entitled to the proceeds of the policies in the proportion that the payments made from the trust funds bear to the total premiums paid and then that the *cestui que* trust may recover the entire proceeds where all the premiums have been paid with trust funds. Both parties agree that *Jansen* v. *Tyler* governs this case, if applicable to the facts here involved (R. 28).

As to the Matter of Estoppel by Public Policy

The Federal courts have grouped the numerous statutes in that field of law relating to national banks to take notice of questions of public policy clearly shown by the pattern of those statutes. The clear intent of the statutory enactments is effectuated by the court's decision. See recent leading case of *Deitrick* v. *Greaney* (1940), 309 U. S. 190, reh. den. 1940, 309 U. S. 697. Public policy once declared is supreme. It is based upon the enforcement of that which is for the public good, 11 Am. Jur. Sec. 125, pp. 411-412. This being an action involving the winding up of the affairs of a national bank is controlled by the provisions of the Act and other related Federal statutes which constitute a complete code for the organization, regulation and winding up of such institutions. See *Cook County National Bank* v. *U. S.* (1883), 107 U. S. 445; *Deitrick* v. *Greaney, supra.*

The Federal banking statutes of the United States, by the very nature of their protective character, form a pattern from which is readily discernible a public policy designed to protect the public generally, and particularly from the fraudulent or criminal acts and unjust enrichment of officers, directors and employees of the banks. Some of the indicia of this policy found in the Federal statutes are:

1. Banks are subject to supervision and examination by the Comptroller of the Currency, U. S. C. Title 12, Sec. 481;

2. Banks are required to make reports of conditions from time to time to the Comptroller of the Currency and to publish such reports, U. S. C. Title 12, Sec. 161;

3. Embezzlement of banks' funds by an officer or employee or agent of the bank, as well as false entries, misapplication, false reports, etc., are constituted criminal offenses under provision of U. S. C. Title 12, Sec. 592.

4. The borrowing of money, either directly or otherwise, by executive officers of the banks is rigorously limited and largely prohibited under provisions of U. S. C. Title 12, Sec. 375a.

5. Directors are required to take and subscribe to an oath of office before entering upon discharge of their duties. U. S. C. Title 12, Sec. 73.

The Congress has enacted numerous other statutes and erected elaborate safeguards to protect the public in its dealing with national banks, U. S. C. Title 12, Chapter 2; with members of the Federal Reserve System, to which all national banks in Continental United States must belong, U. S. C. Title 12, Chapter 3; and with all banks, the deposits of which are insured by the Federal Deposit Insurance Corporation, U. S. C. Title 12, Sec. 264. The United States Supreme Court in its opinion in the case of *Deitrick* v. *Greaney, supra,* enumerated in considerable detail many of the protective and regulatory provisions enacted by Congress. Not only are these and other statutes, as well as regulations of the Federal Bank Supervising Agency (which have the force and effect of law) designed to protect the public in general, but also to protect Federal Deposit Insurance Corporation and the public fund which it administers. *D'Oench Duhme and Company* v. *FDIC* (1942), 315 U. S. 447, reh. den. (1942), 315 U. S. 830; *FDIC* v. *Vest* (C. C. A. 6, 1941), 122 F. (2d) 765, cert. den. (1941), 314 U. S. 696; *General American Life Ins. Co.* v. *Anderson* (Ky. 1942), 46 F. Supp. 189.

In the case at bar, Brown knowingly violated the prohibition against embezzlements, misapplications and false entries; the solemn oath taken by him as a director and the prohibition against officers becoming indebted to the bank. He also made false reports and misrepresentations to the directors and the bank examiners, and otherwise in almost every conceivable manner breached his statutory as well as common law fiduciary duties to the bank to serve his own selfish interests. In this action to recover insurance proceeds illegally and dishonestly acquired, Brown's beneficiary now seeks by way of defense to plead and rely upon the bank records maintained by Brown, which are replete with false entries made with his full knowledge, if not his direction, which records concealed from the honest officers and directors of the Bank, as well as from the bank examiners, the real facts with respect to the status of his deposit accounts and his numerous transgressions. Appellant also seeks to support her contention by relying upon Brown's unconscionable act of omission in not applying his deposits to reduce his abstractions, and his wrongful act of commission in converting the alleged deposits to his own use when the Bank had the indisputable right to set off or appropriate them to reduce its loss. Paraphrasing the language of Mr. Justice Stone in *Deitrick* v. *Greaney, supra,* at page 198:

> It is a principle which derives its force from the circumstances that Brown's acts apart from their possible injurious consequences to creditors are themselves violations of the Federal Statutes; and that the statutes read in the light of their purposes and policy preclude resort to the very acts which they condemn, as the means of thwarting those purposes by preventing the receiver and the creditors of the bank from recovering property to which the bank's funds were dishonestly and unlawfully converted.

Rights or remedies ordinarily enforceable as well as defenses ordinarily available are not recognized by courts when to do so violates and thwarts the legislative policy and where the result would defeat the objectives sought to be accomplished by the legislative safeguards. See *Deitrick* v. *Greaney, supra,* holding that the wrongdoer was estopped to plead accommodation and *D'Oench Duhme and Company* v. *FDIC, supra,* where the court held that want of consideration could not be pleaded and cited numerous stated authorities to the same effect. See also *FDIC* v. *Vest,* *supra,* extending the rule to one who only unwittingly acted in concert with a bank officer.

The doctrine of estoppel by public policy is further buttressed by the axiomatic principle that equity will not extend its aid in the assertion of a mere legal right contrary to the clear equity and justice of the case. *Jones* v. *N. Y. G. & I. Co.* (1880), 101 U. S. 622.

We respectfully submit that the judgment and decision of the court below be affirmed, not only for the reasons argued under the preceding headings but also on the grounds of estoppel as a matter of Federal public policy and as a matter of equity.

As to the Matter of "Salary"

The appellant completely ignores the significant part of the Pre-Trial Order pertaining to Brown's salary (R. 15):

> "That the directors of said Bank, being entirely ignorant of any wrongful acts, embezzlements, misappropriations or defalcations on the part of the said Edward N. Brown of any of the property or assets of the Bank or of any breaches of trust of duty on his part, authorized and fixed his salary in the monthly sums mentioned in said deposit slips as salaries and authorized him to draw on said amounts."

There is neither conflict nor dispute as to these facts.

Brown was prohibited by law from borrowing or becoming otherwise indebted to the Bank (U. S. C., Title 12, Sec. 375a):

> "No executive officer of any member bank shall borrow from or otherwise become indebted to any member bank of which he is an executive officer, and no member bank shall make any loan or extend credit in any other manner to any of its own executive officers;"

and under his oath as a director he swore (U. S. C., Title 12, Sec. 73):

> "* * * that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, and will not knowingly violate or willingly permit to be violated any of the provisions of this chapter."

Brown's manipulation of the records of the Bank not only eluded detection by the other officers and employees of the Bank, but by the national bank examiners as well. His operations succeeded over a period of years. The nub of the matter is not that the Bank did not discover his dishonesty, and exercise its rights against him, but that he drew the salary knowing of his defalcations. Brown violated his oath and breached his trust relationship by his acts of drawing a salary when he knew that in fact he was indebted to the Bank many times more than the said salary.

In the Restatement of Restitution, Sec. 138, is the following:

> "A fiduciary who has acquired a benefit by a breach of his duty as fiduciary is under a duty of restitution to the beneficiary."

The law is well settled that the unfaithful employee is not entitled to salary for a breach of trust or duty, whether the breach be as a result of negligence, want of skill or intentional.[7]

[7] *Peterson* v. *Mayer* (Minn., 1891), 49 N. W. 245, 246; 35 Am. Jur., Master & Servant, Sec. 72, p. 503; *Hahl* v. *Kellogg* (1906), 42 Tex. Civ. App. 636, 94 S. W. 389; *Lahr* v. *Kraemer* (1903), 91 Minn. 26, 97 N. W. 418; 13 L. R. A. 72, Note; *Royal* v. *Royal* (1897), 30 Ore. 448, 47 P. 828; *Winslow* v. *Rutherford* (1911), 59 Ore. 124, 114 P. 930; *W. G. Reddingius Co.* v. *Enkema* (1923), 156 Minn. 283, 194 N. W. 646; and *Neely* v. *Wilmore* (1916), 124 Ark. 460, 187 S. W. 637.

The appellant's position, however, seems to be that since Brown had avoided an accounting that there is now no reason for her to account.

The appellant cites *Sweet* v. *Lang* (CCA 8), 14 F. (2d) 762, in support of her contention. That case falls far short of the facts of the case at bar. The officers in that case all paid their personal obligations with corporation checks. Such transactions were duly charged to their accounts, and interest on the sums so advanced was charged. All the officers had actual knowledge of the practice and acquiesced therein, and the corporation at the time was solvent. Again in the case of *Oliver* v. *Northwestern Mutual Life Ins. Co.* (Pa. 1932), 2 F. Supp. 266, the corporation was solvent and the officers pursuant to agreement, paid their insurance premiums with corporation checks, but there was neither concealment nor fraud perpetrated by the insured under the policy of insurance.

Here, however, there is the additional fact that the appellant is not an injured innocent third party. She gave no consideration, has no property right to be protected and stands in the same position as Brown, were he alive. He was an embezzler and in ignorance of his conduct the Board of Director permitted him to draw his salary.

To overcome the effect on the case at bar, the appellant makes an erroneous assumption of the facts in the case of *Jansen* v. *Tyler, supra,* that "Unquestionably, some of the premium payments which were held to have been made with Tyler's own funds were paid with funds which he drew from his salary account, either as salary or overdraft." This is contrary to the facts stated by the Court:

> "The receiver and Mrs. Woodworth, former treasurer of the company and bookkeeper, who was assisting the receiver, and W. L. Coleman, all of whom are accountants, made a thorough and searching examination of the records and books of the company and testified

> to the effect *that there had not been paid by the company or out of its funds directly or indirectly any premiums upon any insurance policies* upon the life of Mr. Tyler, except the three quarterly premiums on policies No. 629852 and No. 649853, of the New England Mutual Life Insurance Company" (Italics supplied).

There is no basis whatever for the appellant's assumption that the other premiums were paid out of funds which Tyler had misappropriated from the company.

The appellant's contention that the salary drawn by Brown was no more "embezzled funds" than money regularly borrowed from the Bank is spurious reasoning under the circumstances of this case. Brown was in no position to borrow from the Bank; he did not draw the funds as a loan; and he had no intention of repaying the sum.

As to the Matter of "Burden of Proof" and the Trial Court's Alternative Theory Concerning Commingling of Trust Funds.

Appellant contends that the burden of proving that the premiums were paid with money embezzled or wrongfully misappropriated from the Bank is on the FDIC throughout the case and that a failure to show that any of the stolen funds found their way into the premiums should end the case.

The trial court in reasoning this case set forth the alternative theory that the commingling of funds where fraud has once been proven would have achieved an identical result. The appellant concedes that the proof to establish that the premium payments were paid from commingled funds need neither be conclusive nor direct and may be circumstantial.

The text writers say that the duty to separate and distinguish his property is on the defaulting trustee, hence the burden of proof is his.

65 C. J., sec. 899, p. 972:

> "As a general rule the cestui que trust's equitable right of recovery is not destroyed by reason of the fact that the trustee has so commingled the trust property with his own property that it is impossible particularly to identify the trust property; for, unless the trust property is such that it can be ascertained and separated from the rest, the entire commingled fund or property will be treated as subject to the trust, to the extent necessary to make good the claim of the cestui que trust to funds traced to, and still found commingled in, the common fund, except in so far as the trustee may be able to distinguish and separate that which is his own."

The record in this case is replete with clear and convincing proof of Brown's dishonesty and a dearth of proof that Brown had any substantial source of revenue or income other than from avails of money stolen from the Bank. These facts do not permit a presumption of Brown's innocence, and under such circumstances the burden is on appellant to show that the payment of premiums was not made with Bank funds.

The appellant has cited from Bogert, Trusts and Trustees, under the heading of "Tracing Trust Funds." From the same volume and under the same heading (Bogert, Vol. 4, sec. 925, p. 2676) the following is taken:

> "But other courts have aided the cestui in tracing by introducing a presumption that trust assets continued in the hands of the trustee to the time of his death or insolvency. They have held that a cestui makes out a prima facie case for tracing when he shows that trust assets came into the hands of the trustee, and that the burden is then upon the trustee or his successor to prove that those assets were not held by the trustee at his death or insolvency but had been used up in some fashion.
>
> *   *   *   *   *   *   *

> "The cestui may use circumstantial evidence, as where he proves that the trustee had no property or source of income other than the trust funds from which he could have purchased property found in his hands at his death or failure."

The duty of the trustee not to mingle has been stated by Pomeroy, 5th Ed., Vol. 4, sec. 1076:

> "The trustee may not thus mingle trust moneys with his own, even though he eventually accounts for the whole, and nothing is lost. The rule is designed to protect the trustee from temptation, from the hazard of loss, and of being a possible defaulter. When a trustee does mingle trust moneys with his own, the right and lien of the beneficiary attach to this entire combined fund as security for all that actually belongs to the trust estate. (See 1058d.) A violation of this duty subjects the trustee to the following liabilities:
>
> 1. If the mingling is followed by actual loss, accidental or otherwise, the trustee must make good the principal sum lost, together with interest, and perhaps with compound interest.
>
> 2. Where there has been no positive loss, but the whole funds, principal, profits, and proceeds, are in the trustee's hands in their mingled condition the *burden of proof rests upon him* of showing most conclusively what portion is his, and whatever of the mixed fund, including both profits and principal, he cannot thus show to be his own, even though it be the whole mass, will be awarded to the beneficiary. The beneficiary is always entitled to claim and receive the *actual* profits when they can be ascertained."

The appellant has cited from Scott on Trusts. The footnote to the particular quotation cites but two cases. The first is *Tolman* v. *Crowell* (1934), 288 Mass. 397, 193 N. E. 60. In that case a demurrer to a bill to establish a trust in the proceeds of policies of life insurance was sustained because the bill did not allege that the insured had used misappropriated funds in payment of the premiums. The second case is *Bromley* v. *Cleveland C. C. & St. L. Ry. Co.* (1899), 103 Wis. 562, 79 N. W. 741, which is a case that clearly can be distinguished from the case at bar and which is discussed more fully hereinafter.

The proof as to Brown's income incorporated in the pretrial order shows that his operations were too large for his limited "other sources."

The appellant does not dispute that Brown stole, embezzled and misappropriated from the Bank more than $400,000, nor is there any conflict that he was a fiduciary at the time. The premium payments of the insurance here involved at all times amounted to almost $600 annually. His salary was:

In 1935	$160 per month	$1920 annually
In 1936	$195 per month	$2340 annually
In 1937	$225 per month	$2700 annually
In 1938 to 1940	$250 per month	$3000 annually

His only legitimate outside resources were the gifts of cash amounting to $3,600 made in 1930 and 1931, and of which there is no trace in any of his accounts at any time during which the premium payments were made. In three years, 1938 to 1940, he received $15,000.00 (R. 22, 23) for livestock, which was merely his sales and not his holdings. These sales were made by Kidwell & Caswell (R. 9, 10, 22, 23). He must have purchased the livestock, because nowhere was it shown as a gift to him. Of his real estate purchases alone, made from 1935 to 1940, he held at the time of his death in excess of $6,400. There were unexplained items of cash of $690 and the proceeds of "grain" (R. 9) and "steer" (R. 9, 10, 22, 23) accounts passing through the two accounts on which the checks for the premium payments were drawn and honored. The only legitimate source of funds was the $4,000 borrowed and repaid between the years 1938 and 1940. If Brown were alive can there be any doubt that a court of equity under such circumstances would require him to account? Is the appellant in any better position since she is claiming under him?

Appellant admits that the case of *Long* v. *Earle* (1936), 277 Mich. 505, 269 N. W. 577, lays down and correctly applies the proper rule but contends that it is inapplicable here because Brown was dead. The authorities hold otherwise, see *Meyers* v. *Baylor University* (Tex., 1928), 6 S. W. (2d) 393, 394:

> "It is quite true that the burden of proof was upon plaintiff to establish the trust, but, when proof of the fiduciary relationship of the parties was made, the betrayal of the trust, and probable amount of the embezzlements shown, a prima facie case was presented, and the burden was then on Meyers to show, if he could, that his moneys, and not that of the plaintiff, paid for the properties in whole or in part.
>
> "Meyers was in possession of the exact facts, and it was his duty to reveal the entire truth. As he did not testify, and made no explanation of this matter, every intendment is against him. 20 C. J., p. 482, sec. 78; 39 Cyc. p. 476.
>
> "As stated in our conclusions, Meyers deposited his own and money embezzled from plaintiff to his personal credit in the banks, thus destroying the identity of these funds; hence the whole mingled fund became subject to the trust, as well as all property purchased therewith.
>
> "The rule applicable to these facts is clearly and satisfactorily stated in 39 Cyc. p. 538, as follows:
>
> 'Where a trustee so mingles the trust fund or property with his own, or so invests it in property together with his own, that the trust fund or property cannot be

> separated, or the amount of each ascertained, the whole mingled fund or property becomes subject to the trust, except so far as the trustee may be able to distinguish or separate his own fund or property, the burden of making such distinction or separation being on the trustee or *his representative;* and this rule applies so long as any portion of the fund or property into which the trust fund or property can be traced, remains.' " (Italics added.)

Appellant's reliance (p. 49 of her brief) on the case of *Logan* v. *Logan,* 138 Texas 40, 156 S. W. (2d) 507, overlooks two vital distinctions, first, that there was no wrongful commingling of the funds by the father in the *Logan* case, whereas here if there was a commingling it was wrongful; second, that the Court in the *Logan* case reaffirmed the rule in the *Baylor* case when it said, at p. 510:

> "It is a general rule that where a trustee wrongfully mixes trust funds of an indeterminable amount with his own private funds, the burden is on him to distinguish his funds and the amount thereof from those of the cestui que trust; and if he cannot do so the whole commingled fund, or the property purchased therewith, becomes subject to a trust in favor of the cestui que trust. * * *
>
> "The rule is analogous to that of confusion of goods, Andrews v. Brown, supra. It is a harsh one, but is justified by the wrongful conduct of the trustee. The emphasis is on the injustice of requiring an innocent beneficiary to distinguish and trace the trust funds when the commingling was occasioned by the wrongful act of the trustee. It is expressed in Andrews v. Brown, supra [10 S. W. 2d 709], as follows: 'The principle, we apprehend, is but a part of equity's declination to extricate the wrongdoer from self-imposed hard conditions, or to tax the innocent, where one or two not in parti delicto must suffer.'
>
> "We do not contend that death of a fiduciary creates a presumption of dishonesty so as to place the burden

> of tracing on the cestui but we do vigorously assert that the death of the fiduciary who has been shown to be dishonest and to have wrongfully commingled his funds with those of his cestui, does not shift the burden to the cestui to distinguish his funds from those of the unfaithful trustee. Death alone does not create a presumption of dishonesty, but neither does death overcome proof of dishonesty."

There is nothing in the opinion in the case of *Mass. Bonding & Ins. Co.* v. *Josselyn* (1923), 224 Mich. 159, 194 N. W. 548, to warrant the inference suggested by appellant. The case stands for the proposition quoted below and nothing more:

> "It is an elementary rule that a trustee may make no profit out of the handling of a trust estate. It is also well settled that, where money held upon trust is misapplied by the trustee, and traced into an unauthorized investment in property of any nature, the investment thus made, in the absence of a claim of bona fide ownership by a third person, may be treated by the cestui que trust as made for his benefit. * * * The consideration for the investment is trust money and the cestui que trust becomes the equitable owner of the property purchased therewith. His right thereto is a property right, not one created by any preference or favoritism shown by a court of equity.
>
> * * * * * * *
>
> "We are unable by any process of reasoning to apply any different rule to trust moneys used in the payment of life insurance premiums."

As to the case of *Moseley* v. *Fikes* (Tex. Civ. App. 1939), 126 S. W. (2d) 589, the appellant admits that the burden to separate funds is on the trustee who commingles funds if he is alive, but denies that Brown was guilty of any such practice.

In *Picciano* v. *Miller* (Idaho, 1942), 137 P. (2d) 788 the facts are that M was employed by P. In 1935 M bought a house for $1500, on which he put improvements costing $2000, at a time when his salary was $100 a month. He claimed that he was a partner and entitled to about $50.00 per week. The jury found that their relationship was not as partners, but as employer and employee. In the four years under examination M, therefore, had no income other than his salary of $4800. He borrowed $821.64 and his legitimate receipts were $5621.64, of which he expended $3817.65, leaving $1803.99, or an average of $37.58 per month for the four years with which to pay living expenses of his wife and himself, taxes and insurance on the property purchased, and automobile expenses. The court on the matter of tracing said:

> "While appellant might contend that all of the purloined money went into the living expenses and that he used only the money he received legitimately to pay upon the house, it was a reasonable deduction for the trial court to make that some part of the purloined money went into the purchase and improvement of the real property. Hence, there was a sufficient tracing to bring the case within the last rule above noted."

On rehearing, the court reversed itself. The court was divided in both the original opinion and on the rehearing. The case turned on the divided views of the court's evaluation of the facts. It is of little weight in the present situation.

Aside from the facts that at all times Brown had no actual balance in his accounts, there are the items of cash, the proceeds of his grain and cattle sales traced into his accounts. It will be argued that these were the fruits of his operations founded on his own sources, but this can scarcely be credited in face of the overwhelming odds that with over $400,000 of embezzled money and only $4000 borrowed money he could invest $6400 in real estate and be holding it at his death, and sell off some of his cattle for $15,000.

Assuming that all of the items in Brown's several accounts were not open to question, the predominantly important factor is that at no time during the period here involved did he have any credit balance with the Bank; the deposits he did make, even if legitimate, created no balance of credit in his favor, for at all times his indebtedness arising from his criminal conduct far exceeded the deposits.

The foregoing authorities are cited, quoted from and discussed to demonstrate and show the soundness of the trial court's alternative theory that had there been a commingling of funds, where fraud has once been proven an identical result would have ben achieved. FDIC does not contend that the facts justify a finding there was a commingling of funds in the case at bar. The cited cases and quotations clearly indicate, however, the inescapable burden of the appellant to prove that Brown had an actual credit balance (not a fictitious or extinguished credit balance) in his accounts with the Bank at the time the checks drawn on said accounts in payment of the insurance premiums were honored by the Bank. In the absence of such proof it must be conceded that the payment of premiums was made with Bank funds.

As to the Matter of "Withdrawing Own Funds"

Brown knew, and he alone, that at no time when he either issued or the Bank honored the checks in payment of the insurance premiums was the Bank indebted to him. He knew that there were no funds legally to his credit on which he could draw, or on which the Bank could properly honor his checks. He also knew that the Bank in honoring the checks was not loaning him the money, or extending credit to him, but that the Bank was deceived into paying out its funds by reason of his false entries and dishonest conduct. He alone was responsible for the deception.

The case of *Bromley* v. *Cleveland C. C. & St. L. Ry. Co., supra,* is no authority in the case at bar for the contention claimed by appellant. Her contention is that if Brown's deposits were part legitimate and part embezzled funds, it would be presumed that his withdrawals would be on the legitimate part first until that was exhausted. In that case the insured had deposited in his account funds of his wife, which he held in trust and part of which he held for the specific purpose of paying insurance premiums, and the funds belonging to several railroads which he had collected and was bound to return. The court held (page 743) that the insured's relation to the railroads was that of creditor and debtor rather than a trustee, and that the insurance premiums were, therefore, paid from the trust funds of his wife, for which she had given him funds. The wife was the beneficiary of the policy. The presumption was that he withdrew the trust and specific funds for paying the premiums rather than the funds of the railroads.

Here the question is whether or not there was any credit, in fact, in the Bank belonging to Brown, on which he might draw for the payment of premiums. It is not a question of which of two parties are entitled to a commingled fund.

The case of *Portland Building Company* v. *Bank of Portland,* (1924), 110 Ore. 61, 222 Pac. 740, cited by appellant is of little value here. In that case the bank was a trustee mortgagee of a mortgage given by a building company, on which bonds of the company had been issued. Pursuant to the terms of the mortgage the company paid to the bank the necessary funds with which to redeem the bonds and coupons that had been issued. The bank held the funds, as trustee, in a special account and not as a general deposit. When the bank failed, the superintendent of banks denied the building company a preference because at all times it was shown that the bank had in its possession cash in excess of the amount of the trust funds. It was presumed that in honoring the checks drawn against it in payment of its other obligations, the bank did not wrongfully use trust funds to meet these obligations.

In the case at bar, Brown's accounts were all general deposits and were part of the general deposits of the Bank. They were the funds of the Bank and not of Brown. When he drew premium checks the relationship was that of debtor and creditor, but he was the debtor, not the creditor. Therefore, when the Bank honored his checks it was not discharging an actual obligation it owed him, but was using its own funds.

Specification of Error III

Appellant's specification of Error III contends that the trial court abused its discretion in denying appellant's motion for new trial, since it was made to appear that an audit of the Bank's records disclosed that Brown was not indebted to the Bank in the years when the various premium payments were made, so that the whole basis of the court's holding against appellant was incorrect.

The contention was submitted by appellant in support of the motion to amend the pretrial order and for a new trial, and was denied by the trial court.

Appellant had the opportunity of having an audit made at the time of the pretrial and of the settlement of the pretrial order, but did not do so. Moreover, the auditors who made the examination of the Bank on behalf of the FDIC were in attendance at the pretrial, testified, and could have been cross-examined by counsel for appellant. Although the truth of the figures submitted by the FDIC auditors was not conceded by appellant, it was admitted that the FDIC could produce evidence to substantiate its offer and thus the pretrial order was completed and entered.

The appellant's auditor reported to appellant's counsel that it appeared probable (not a fact, but merely probable) that Brown was not indebted to the Bank by reason of his embezzlements and misappropriations during the years 1935, 1936, 1937, 1938 and perhaps in the subsequent years except 1942. The affidavit in support of the motion was made by appellant's counsel, not by the auditor. This evidence is the same as that by which counsel sought to retry the case. Such evidence was not presented to the court and no opportunity was afforded to cross-examine the auditor whom counsel quotes. Moreover, appellant's counsel did not permit the introduction of the testimony of the FDIC's auditors in substantiation of the shortages set up in the stipulated evidence.

Conclusion

The facts of this case set forth in the pretrial order were agreed to and are free of contradiction or dispute. The case was tried in August 1943, and after submission of comprehensive briefs was decided by the court on July 12, 1944. The motion to amend the pretrial order and for a new trial was filed November 28, 1944, and denied by the court on January 8, 1945.

Appellant has failed completely to prove that any of Brown's money was used to pay the premiums on his life insurance, whereas appellee has shown both as a matter of fact and of law, that all premiums save one were paid with embezzled or misappropriated funds of the bank. Moreover, in the circumstances of this case appellant is estopped as a matter of public policy and of equity to take the benefits of the defaulter's ill-gotten gains at the expense of the Bank and FDIC.

The decision and judgment of the court below is correct, according to well established law, and should be sustained.

The motion for a new trial was properly denied by the trial court.

Respectfully submitted,

Maguire, Shields & Morrison,
Robert H. Agnew,
Attorneys for Appellee,
723 Pittock Block,
Portland 4, Oregon.

James M. Kane,
135 So. LaSalle Street,
Chicago 3, Illinois.

Edward C. Klein,
135 So. LaSalle Street,
Chicago 3, Illinois,
Of Counsel.

APPENDIX

U. S. C. Title 12, Sec. 264 (l) (1)

"The Temporary Federal Deposit Insurance Fund and the Fund For Mutuals heretofore created pursuant to the provisions of this section are hereby consolidated into a Permanent Insurance Fund for insuring deposits, and the assets therein shall be held by the Corporation for the uses and purposes of the Corporation: *Provided,* That the obligations to and rights of the Corporation, depositors, banks, and other persons arising out of any event or transaction prior to August 23, 1935 shall remain unimpaired. On and after August 23, 1935, the Corporation shall insure the deposits of all insured banks as provided in this section: *Provided,* That the insurance shall apply only to deposits of insured banks which have been made available since March 10, 1933, for withdrawal in the usual course of the banking business: *Provided further,* That if any insured bank shall, without the consent of the Corporation, release or modify restrictions on or deferments of deposits which had not been made available for withdrawal in the usual course of the banking business on or before August 23, 1935, such deposits shall not be insured. The maximum amount of the insured deposit of any depositor shall be $5,000. The Corporation, in the discretion of the board of directors, may open on its books solely for the benefit of mutual savings banks and depositors therein a separate Fund For Mutuals. If such Fund is opened, all assessments upon mutual savings banks shall be paid into such Fund and the Permanent Insurance Fund of the Corporation shall cease to be liable for insurance losses sustained in mutual savings banks: *Provided,* That the capital assets of the Corporation shall be so liable and all expenses of operation of the Corporation shall be allocated between such Funds on an equitable basis."

U. S. C. Title 12, Sec. 264 (l) (7)

"In the case of a closed national bank or District bank, the Corporation, upon the payment of any depositor as provided in paragraph (6) of this subsection, shall be subrogated to all rights of the depositor against the closed bank to the extent of such payment. In the case of any other closed insured bank, the Corporation shall not make any payment to any depositor until the right of the Corporation to be subrogated to the rights of such depositor on the same basis as provided in the case of a closed national bank under this section shall have been recognized either by express provision of State law, by allowance of claims by the authority having supervision of such bank, by assignment of claims by depositors, or by any other effective method. In the case of any closed insured bank, such subrogation shall include the right on the part of the Corporation to receive the same dividends from the proceeds of the assets of such closed bank and recoveries on account of stockholders' liability as would have been payable to the depositor on a claim for the insured deposit, but such depositor shall retain his claim for any uninsured portion of his deposit: *Provided,* That, with respect to any bank which closes after May 25, 1938, the Corporation shall waive, in favor only of any person against whom stockholders' individual liability may be asserted, any claim on account of such liability in excess of the liability, if any, to the bank or its creditors, for the amount unpaid upon his stock in such bank; but any such waiver shall be effected in such manner and on such terms and conditions as will not increase recoveries or dividends on account of claims to which the Corporation is not subrogated: *Provided further,* That the rights of depositors and other creditors of any State bank shall be determined in accordance with the applicable provisions of State law."

U. S. C. Title 12, Sec. 264 (n) (4)

"Whenever in the judgment of the board of directors such action will reduce the risk or avert a threatened loss to the Corporation and will facilitate a merger or consolidation of an insured bank with another insured bank, or will facilitate the sale of the assets of an open or closed insured bank to and assumption of its liabilities by another insured bank, the Corporation may, upon such terms and conditions as it may determine, make loans secured in whole or in part by assets of an open or closed insured bank, which loans may be in subordination to the rights of depositors and other creditors, or the Corporation may purchase any such assets or may guarantee any other insured bank against loss by reason of its assuming the liabilities and purchasing the assets of an open or closed insured bank. Any insured national bank or District bank, or, with the approval of the Comptroller of the Currency, any receiver thereof, is authorized to contract for such sales or loans and to pledge any assets of the bank to secure such loans.''

Excerpts from Agreement Between Bank and F. D. I. C.

''This Agreement, made and entered into this 29th day of August, 1942, by and between the Harney County National Bank of Burns * * * and the Federal Deposit Insurance Corporation * * *

''Witnesseth:

* * * * * * *

''Whereas, the Bank proposes to sell certain of its assets to The United States National Bank of Portland * * * in consideration of the assumption of the deposit liabilities of the Bank as shown by the Bank's books as of the close of business on the date hereof; and

''Whereas, the Bank has filed an application requesting the Federal Deposit Insurance Corporation to purchase certain assets of the Bank and/or to loan money on the security of said assets in order to facilitate and make possible the proposed sale of assets to, and the aforesaid assumption of the deposit liabilities by The United States National Bank of Portland; and

''Whereas, the Board of Directors of the Federal Deposit Insurance Corporation has determined that the Federal Deposit Insurance Corporation will not make a loan to the Bank but will purchase, on certain terms and conditions, all of the assets of the Bank not purchased and acquired by The United States National Bank of Portland, as aforesaid, and has concluded that such purchase of assets by the Federal Deposit Insurance Corporation will reduce a risk and avert a threatened loss to the Federal Deposit Insurance Corporation; and

* * * * * * *

"Now, Therefore, each of the parties hereto intending to be legally bound hereby, do severally undertake, promise, covenant, and agree each with the other, and the Bank does hereby represent, warrant, covenant and agree to and with the Federal Deposit Insurance Corporation, as follows:

* * * * * * *

"Without any limitation on the generality of the foregoing, the property so sold, granted, conveyed, assigned, transferred and set over to the Corporation * * * shall expressly include, without being limited to, each and all of the following:

* * * * * * *

"(2) All assets of the Bank which are not carried on its books of account or which are carried on such books at a nominal amount for bookkeeping purposes.

* * * * * * *

"(5) All contracts, rights, claims, demands, choses in action or causes whatsoever, pending causes of action, and judgments, whether known or unknown, which the Bank owns, holds or has against any person or persons whomsoever, including, without being limited to, any claims against its stockholders for payment of or by reason of ownership of its capital stock (neither the mention of the foregoing liability or the approval of this agreement by the Bank and/or its stockholders shall be deemed an admission by said Bank or stockholders of the existence of such liability) any claims against its directors, officers or employees or their sureties arising out of any act of any such persons in respect to the Bank of its property or arising out of the non-performance or manner of performance of their duties, any claims against any person for money or property of the Bank, or for damages, which the Bank may have or own."